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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

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SEP 14 1993
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

REPLY COMMENTS

CABLE TV OF GEORGIA LIMITED PARTNERSHIP
FALCON CABLE TV
INSIGHT COMMUNICATIONS
MID-AMERICA CATV ASSOCIATION
MOUNT VERNON CABLEVISION INC.
NASHOBA COMMUNICATIONS
PENNSYLVANIA CABLE TELEVISION ASSOCIATION
PRESTIGE CABLE TV
WESTSTAR COMMUNICATIONS
WHITCOM INVESTMENT COMPANY

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Date: September 14, 1993

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Cable TV of Georgia Limited Partnership, Falcon Cable TV, Insight Communications, Mid-America CATV Association, Mount Vernon Cablevision Inc., Nashoba Communications, Pennsylvania Cable Television Association, Prestige Cable TV, WestStar Communications and Whitcom Investment Company (the "Commenters"), through their attorneys, hereby reply to certain of the comments submitted in response to the Notice of Proposed Rulemaking in the above-captioned proceeding. Although Commenters disagree with a number of positions taken by various parties, these reply comments are restricted to two issues which Commenters believe are fundamental to the entire process. Commenters oppose the suggestion put forth by certain members of the telephone industry that a telephone industry price cap regulatory model is appropriate for the cable industry. Second, Commenters also strongly oppose the position advocated in the comments of municipal regulators that intangibles such as goodwill, subscriber lists and acquisition costs should be excluded entirely from the rate base in any cost of service proceeding. Each of these issues will be addressed in turn.

A. The Telephone Industry Rate Model is Inappropriate for the Cable Television Industry.

A number of comments submitted by telephone industry participants have urged the Commission to model its cost of service rules upon the telephone price cap model which is currently used in the telephone industry.[1] These parties argue that because of technology convergence which is blurring the lines between the types of telecommunications services offered by telephone companies and the entertainment services offered by cable television systems, parity requires that the two industries be regulated in the same manner. This argument is flawed for several reasons.

Initially, the provision of telephone service has always been regulated on a common carrier basis as a utility service. Telephone service is recognized as a monopoly necessity as is evidenced by the fact that virtually all homes to which telephone service is available have telephone service. In contrast, cable television service is a discretionary entertainment service which has not been regulated as a utility.[2] The discretionary nature of this service is evidenced by the fact that nearly four out of ten homes which have cable service available choose to obtain their television information and entertainment from other sources.[3] Not surprisingly, the non-essential nature of cable service is reflected in a greater price sensitivity in the provision of cable service than is the case for telephone service. These differences alone justify different regulatory treatment for the telephone and cable industries.

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[1]See, Comments of Bell South Telecommunications, Inc.; Joint Comments of Bell Atlantic, The NYNEX Telephone Companies, and the Pacific Companies; and Comments of GTE Service Corporation and affiliates.

[2]Section 621(c) of the 1984 Cable Act, 47 U.S.C. § 541(c), flatly prohibits utility or common carrier regulation of cable services offered by cable systems.

[3]Cable Television Developments, June 1993, National Cable Television Association.

Second, the telephone industry is much larger and much more homogeneous than is the cable industry. The provision of local exchange service is dominated by a handful of regional Bell companies and one or two independent operators whose maturity, costs, form of organization and competitive situations are very similar, which is not surprising given the fact that the seven regional Bell companies evolved from the same single Bell entity prior to divestiture. In contrast, cable companies represent a remarkably diverse industry where companies differ as to size, MSO affiliation, ownership structure and capitalization, factors which do not readily lend themselves to the standardization and average values which underpin regulation of the telephone industry.

Third, the telephone company price cap model represents an attempt by regulators to move away from traditional cost of service regulatory models which encouraged excessive investment in rate base by rewarding increased efficiency in operations with higher profits. In effect, the move towards price caps in the telephone industry represents an attempt to provide incentives for regulatorily protected utility companies to act more like free market entities in the face of increasing competition. The imposition of rate regulation upon cable television systems represents an entirely different set of concerns than that faced by the telephone industry based upon differences in the regulatory history of those two industries.

Section 623(b)(1) of the 1992 Cable Act specifically directs the Commission to design its rate regulations "to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such system were subject to effective competition."[4] Similarly, with respect to cable programming services, the Commission is directed to establish criteria for "identifying in individual cases rates for cable programming services that are unreasonable."[5] The concern here, in moving cable television systems from an unregulated to a regulated environment, is to protect subscribers from excessive rates due to the absence of effective competition and not, as is the case with telephone price caps, to provide incentives for protected monopoly utilities such as the telephone companies to become more operationally efficient.

Fourth, there are vast differences in the sources and costs of capital as between telephone companies and cable system operators. Most cable operators, particularly operators which are not extremely large, have no public equity or public debt component to their capital structures. Their sources of capital are primarily banks and insurance companies for debt capital and venture capital funds for equity capital. Each of these capital sources exacts a cost well in excess of the amounts paid by telephone companies.[6] Moreover, cable companies usually have to repay banks in approximately an 8-year timeframe while the public market lenders utilized by telephone companies allow longer repayment periods of up to thirty years. The impact of these differences cannot be overemphasized. According to an article that appeared recently in The Wall Street Journal,[7] the cable industry will need between $20 and $43 billion to upgrade its infrastructure for futuristic uses. "The problem: Most cable companies' debt ratings . . . languish in junk-

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[4]47 U.S.C. § 543(b)(1).

[5]47 U.S.C. § 543(c)(1)(A).

[6]This also illustrates why an industry-wide rate of return surrogate is inappropriate. Not only is cable television different from telephone companies in the matter of risk and capital cost, but also cable companies differ greatly within the industry.

[7]The Wall Street Journal, August 26, 1993, p. B4.

bond territory, while their rivals, the phone companies, have easy access to vast pools of investment-grade money." Access to capital therefore is becoming an ever more crucial issue for cable operators as they seek to compete in the provision of new services. Attempts to fit cable systems into the mold of telephone company rate regulation will only make the attraction of capital more difficult and the achievement of the policy goals set forth by Congress in the 1992 Cable Act more problematic.

Finally, it is somewhat ironic that the telephone companies are arguing that technology convergence should justify imposing telephone industry regulatory models upon the cable industry when in fact the competition arising from such convergence would in many cases result in the deregulation of rates for both industries. For example, under the 1992 Cable Act, the existence of effective competition for cable services, such as where a cable operator faced competition from a video dialtone service provider, would result in a deregulation of cable programming service rates for both providers.[8] Similarly, many state public utility commissions have enacted regulations which expressly provide for streamlined rate approval in cases where the local telephone company is able to demonstrate that competition exists for a particular telecommunications service. Under such regulations, the provision of voice and other telecommunications services by a cable television company would result in a virtual deregulation of the rates for such services provided by the local telephone company. Accordingly, the presence of technology convergence, and the competition which that convergence engenders, supports the removal of regulation in areas where the two industries provide the same service in a

[8]47 U.S.C. § 543(a)(2).

competitive manner and not the imposition of a telephone company pricing model upon the provision of cable television services in areas where such competition does not exist.

B. Intangible Assets Are a Demonstrably Proper Component of the Rate Base.

The second issue which the Commenters wish to address concerns the valuation of the rate base and the treatment of intangibles for rate making purposes. Not surprisingly, a number of comments submitted by municipal regulators have endorsed the concept that original cost methodology should be used to determine the value of the rate base and that most or all of the value of intangibles, such as subscriber lists, franchise rights and goodwill, should be excluded from the rate base as "excess acquisition costs."[9] Because original cost methodology and the exclusion of intangibles produces the smallest rate base and therefore the lowest permitted rates, it is not surprising that this concept has received strong support from municipal regulators. However, the Commission must keep in mind that its statutory mandate is to ensure that subscriber's rates are reasonable, not necessarily the lowest possible. Accordingly, unlike municipal regulators who, as elected officials, have a vested political interest in seeing the lowest possible rate, the Commission must take into account the impact of its ratemaking policies on its ability to carry out the other policy goals embodied in the 1992 Cable Act which include promoting diversity of services and ensuring that cable operators continue to expand their capacity and programming.[10]

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[9]See, e.g., Comments of Michigan Ad Hoc Committee for Fair Cable Rates; Comments of Counsel to the Municipal Franchising Authorities; Comments of the National Association of Telecommunications Officers and Advisors, et al.; Comments of Utah league of Cities and Towns; and Comments of Austin, Texas, et al.

[10]1992 Cable Act at §§ 2(b)(1), 2(b)(3).

Commenters submit that the use of an original cost methodology and the exclusion of intangibles do not reflect the true value of the capital invested in the cable industry. Reliance on original cost and exclusion of intangibles to determine the rate base would render the cost of service methodology completely ineffective as a "backstop" to the Commission's rate benchmarking approach. Of all the choices proposed by the Commission for determining the rate base, original cost is the most inappropriate for the cable industry. The ownership of many cable systems has changed hands at least once (and in some cases several times) during the last decade during which the industry has consolidated and matured. This industry growth and consolidation has resulted in increased channel capacity, increased diversity of service and the extension of cable plant into rural, sparsely populated areas of the country that would not have otherwise been served. Without system consolidation, entailing as it does the sale and purchase of cable systems, the increasing diversity of service and deployment of fiber plant would not have taken place. Given the fact that the Commission has itself recognized that cable operators doing business in an unregulated environment paid prices in excess of physical plant valuation based on factors that were entirely proper at the time,[11] the Commission must adopt an approach for valuing the rate base which presumptively includes all of the capital which has actually been invested in the system and which would more accurately reflect the true rate base of a cable system at a time when the industry is making a transition from a totally unregulated to a regulated environment. Any cost methodology which excludes some or all intangible costs which comprise a substantial portion of a cable system's "going concern" value cannot reflect the rate base that the regulator and cable operator find in place on the day that regulation begins.

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[11]Notice of Proposed Rulemaking, n.40.

Cable system operators, investors and lending institutions have financed and paid for the intangible assets of cable television systems fully expecting to be able to recover their investment and earn a reasonable return thereon over the duration of the cable franchise. Exclusion of intangibles from the rate base would preclude that expectation. The Commission's concern that intangibles might reflect the value of monopoly rents is unfounded. A number of other businesses which cannot be characterized as monopolies are valued in the same way that cable systems have been valued in the absence of regulation. For example, the fact that broadcast properties are valued at higher premiums over plant in urban areas (where there is more competition) and that laundries are valued based on their customer lists and not upon the value of their plant indicate that the value of intangibles is a significant and often substantial factor in determining the going concern value of the underlying business. Indeed, even Congress expressly required that such going concern value be taken into account whenever a franchising authority acquires or effects a transfer of a cable system to a third party.[12] This strongly evidences a clear Congressional intent that the going concern value of the cable operations be considered part of the rate base.

Even if some portion of intangibles could be attributed to monopoly rents, a conclusion which Commenters dispute, it is manifestly true that other portions of the intangible value can be clearly attributed to the value of the franchise, ongoing goodwill and subscriber lists. For example, the 1992 Cable Act's prohibition on the transfer of any cable system within three years of its initial construction clearly presumes that a bare franchise has some value.[13] Otherwise, there would be no reason to prohibit the trafficking of franchise rights in an unbuilt cable system.

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[12]See 1984 Cable Act, § 627(a)(1), 47 U.S.C. § 547(a)(1).

[13]47 U.S.C. § 537.

Similarly, the fact that Section 621 of the 1984 Cable Act precludes a cable operator from providing cable service in any community without a franchise demonstrates that value is ascribed to the franchise apart from the physical assets of the system and that such a value must be recognized by the Commission in establishing its rate base methodology.[14] Indeed, the fact that the IRS and Congress allow for franchises, subscriber lists and other intangibles to be depreciated shows that these assets are part of the value of the business, a value which should be included in any rational rate base methodology.[15]

The fundamental thought which Commenters wish to leave with the Commission is that an intangible value, above and beyond the cost of the actual physical assets, is a valid and accepted component of the worth of a going concern. Its inclusion in cable system valuations for acquisition, financing and investment purposes is a marketplace reality. Moreover, the use of intangibles as part of a system's asset base is consistent with GAAP and the Internal Revenue Code. All of this has nothing to do with whether a business is or is not a monopoly. The unimpeachable principle is that intangibles are a legitimate part of a cable system's rate base. It can perhaps be argued that some portion of acquisition costs are "excess," i.e., a monopoly rent. If such amounts can be properly identified, then their exclusion from the rate base on a prospective basis could be accomplished.[16] However, by no stretch of the imagination can

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[14]47 U.S.C. § 541(b)(1).

[15]See, Commenters' initial comments, n.31.

[16]To the extent that the Commission wishes to disallow any intangible assets in determining rate base, it should limit this result to investments made on a prospective basis following the effective date of its cost of service regulations and should provide for a transition mechanism to allow for existing intangibles, as shown on the books of cable systems as of that date, to be included in the rate base for the purposes of setting a cable system's initial rates.

exclusion of intangibles per se from the rate base be rationalized. Such a proposition would be unfair, confiscatory and counterproductive.

CONCLUSION

Commenters submit that the Commission should reject the arguments calling for adoption of a telephone industry rate model for cable television and for the expansion of intangibles from the cable television rate base.

Respectfully submitted,

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I HEREBY CERTIFY that a true and correct copy of the foregoing Reply Comments were served via first-class mail, postage prepaid on the 14th day of September, 1993 upon the following parties:

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